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September 25, 2002

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: Demand Side Management Performance Incentive Proposal for 2002
NSTAR Electric, D.T.E. 00-63

Dear Secretary Cottrell:

Pursuant to Section 1(2) of the Department of Telecommunication and Energy's (the "Department") Guidelines for the Methods and Procedures for the Evaluation and Approval of Energy Efficiency Programs ("Guidelines") (see D.T.E. 98-100, at Attachment 1), NSTAR Electric requests approval from the Department to use the performance incentive calculation and rate set forth in this letter in 2002. This proposal has the support of the Northeast Energy Efficiency Council, The Energy Consortium, and the Low Income Intervenors (Action, Inc., Massachusetts Energy Directors Association, Low-Income Energy Affordability Network ("LEAN"), Massachusetts Community Action Association, Massachusetts Senior Action Council, and Cape Organization for Rights of the Disabled), all parties to the Offer of Settlement in the above-captioned proceeding.[1]

On April 10, 2002, with the support of the parties listed above, the Company filed a final update of a 2002 budget and proposed performance incentives. In the discussion of performance incentives related to energy efficiency activities in 2002, the update stated that the Company, parties to the Offer of Settlement, and other electric distribution companies had agreed to work together to develop (1) an incentive calculation and the rate to be used in 2002 and (2) a performance-based incentive mechanism for the period 2003 through 2007, both subject to Department approval. This letter covers the proposal for 2002. The proposal for 2002 is the result of extensive discussions and review by the Company, parties to the Offer of Settlement, and other Massachusetts electric distribution companies. These parties have also reached agreement in principle concerning the

1 The only remaining party to the Offer of Settlement, the Conservation Law Foundation, Inc., withdrew from the proceeding on July 31, 2002.

proposed performance incentive mechanism for the period 2003 through 2007. We expect to resolve technical details and submit a complete 2003-2007 incentive proposal to the Department later in 2002.

Section 5 of the Guidelines sets forth the method by which the distribution companies should calculate performance incentives. In brief, the Guidelines state that a distribution company which meets at least 75% of its performance goals may earn an after-tax performance incentive equal to the product of (1) the average yield of the three-month United States Treasury bills issued in the most recent twelve months, (2) total program implementation costs as included in the Company's energy efficiency plan, and (3) the level of performance actually achieved (capped at 125%).

For the program year 2002, the Company requests Department approval to substitute 4.25% for the average yield of the three-month United States Treasury bills issued in the most recent twelve months. The three-month United States Treasury bill rate has been quite unstable in the past few years, ranging from 1.65% in August 2002 to 6.36% in November 2000. At this time, the average yield for the most recent twelve months is 1.87% and the average for the current calendar year based on data available for January through August 2002 is 1.74%. This causes great unpredictability in the amount the Company is entitled to receive as a shareholder incentive for its energy efficiency achievements. Commenters in D.T.E. 98-100, including the Division of Energy Resources, noted their expectation that the yield on 3-month United States Treasury bills could be expected to vary between 4% and 6%. The proposed rate applicable to 2002, 4.25%, is on the low end of that expected range.

This recent decline and instability of the yield on 3-month Treasury bills reduces the level of incentive earnings for the Company, which has no control over the rate. A rate of 4.25% allows for a performance incentive that can motivate the Company in a meaningful way. It also strikes a balance between the objective of promoting effective programs and the objective of protecting the interests of ratepayers.

Thank you very much for your attention to this matter.

Very truly yours,

Andrew O. Kaplan

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cc: Service List